

# **Audit Report**

## **Ndlambe Municipality**

For the Year ended 30 June 2012

# **FINAL REPORT OF THE AUDITOR-GENERAL TO EASTERN CAPE PROVINCIAL LEGISLATURE AND THE COUNCIL ON NDLAMBE LOCAL MUNICIPALITY ON NDLAMBE LOCAL MUNICIPALITY**

## **REPORT ON THE FINANCIAL STATEMENTS**

### **Introduction**

1. I have audited the financial statements of the Ndlambe Local Municipality set out on pages 1 to 46, which comprise the statement of financial position as at 30 June 2012, the statement of financial performance, statement of changes in net assets and the cash flow statement for the year then ended, and the notes, comprising a summary of significant accounting policies and other explanatory information.

### **Accounting officer's responsibility for the financial statements**

2. The accounting officer is responsible for the preparation and fair presentation of these financial statements in accordance with South African Standards of Generally Recognised Accounting Practice (SA Standards of GRAP) and the requirements of the Municipal Finance Management Act of South Africa, 2003 (Act No. 56 of 2003) (MFMA) and the Division of Revenue Act of South Africa, 2011 (Act No. 6 of 2011 as amended) (DoRA), and for such internal control as the accounting officer determines is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.

### **Auditor-General's responsibility**

3. My responsibility is to express an opinion on these financial statements based on my audit. I conducted my audit in accordance with the Public Audit Act of South Africa, 2004 (Act 25 of 2004) (PAA), the *General Notice* issued in terms thereof and International Standards on Auditing. Those standards require that I comply with ethical requirements and plan and perform the audit to obtain reasonable assurance about whether the financial statements are free from material misstatement.
4. An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgement, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.
5. I believe that the audit evidence I have obtained is sufficient and appropriate to provide a basis for my qualified audit opinion.

### **Basis for qualified opinion**

#### **Property plant and equipment**

6. Property, plant and equipment (PPE) is disclosed in the statement of financial position and note eight to the financial statements at R127,9 million (2011:R98,9 million). Included in this amount are infrastructure related assets of R112,9 million (2011: R85,2 million). Sufficient appropriate audit evidence was not available to support the reasonableness of the calculations

performed and assumptions made in the determining the deemed costs of these assets in the first time adoption of GRAP 17, "Property, Plant and Equipment." Inadequate record keeping prevented the application of alternative procedures and consequently I could not determine whether adjustments were required to the infrastructure related assets, as well as depreciation, which was not provided for by the municipality.

7. Included in PPE is land and buildings of R8,5 million (2011: R8,5 million). Amounts included in the financial statements were not in agreement with the underlying fixed asset register as well as the valuation roll. I could perform alternate procedures and consequently could not determine whether any adjustments were required to land and buildings.

#### **Revenue: Grants and subsidies**

8. Agreements have not been established between the municipality and third parties providing grant funding for grants totalling R3,2 million. Consequently, I was unable to determine whether grants revenue was recognised appropriately, as there were no agreed upon conditions attached to the funding. I was therefore unable to determine whether any adjustments to grants revenue and unspent conditional grants liability were required.

#### **Expenditure: Bulk purchases**

9. I was unable to obtain sufficient appropriate audit evidence about the classification and occurrence of bulk purchases expenditure of R3,2 million. I was unable to confirm the expenditure by alternative means and could therefore not determine whether any adjustment to this amount was necessary.

#### **Expenditure: Operating leases**

10. The municipality recorded operating lease expenditure of R1,8 million (2011: R1,6 million) based on invoiced amounts, in the statement of financial performance. The municipality is required to record operating lease expenditure on the straight-line basis over the lease term per GRAP 13.40 "Leases". Lease agreements are not maintained by the municipality and as a result I could not obtain sufficient appropriate audit evidence as to the straight-line value of operating leases, or the adjustment required to the operating expense amount as recorded.

#### **Irregular expenditure**

11. Due to inadequate record keeping and the decentralisation of the Supply Chain Management (SCM) function at the municipality, I was unable to obtain sufficient appropriate audit evidence to confirm that contracts awarded, that resulted in expenditure in the current financial year of R3,1 million, were made in accordance with the requirements of the SCM legislation.
12. No alternative audit procedures could be performed to obtain reasonable assurance that the expenditure incurred on these awards was not irregular.
13. Consequently, I was unable to determine whether any adjustment relating to the disclosure of irregular expenditure in note 37 to the financial statements was necessary.

#### **Provision for landfill sites**

14. Provision for landfill sites was not disclosed in the statement of financial position or in the notes to the financial statements for 2012. Management have not determined the value of the provision in the current year as required by SA Standards of GRAP 19.19 "Provision, Contingent liabilities and Contingent Assets" and consequently there is insufficient evidence to conclude on this account balance.

### **Material losses of water and electricity**

15. As reported in prior periods, water distribution losses are not monitored by the municipality, as there are no bulk water meters at the purification works to monitor the amount of water supplied to the municipality. Additionally, electricity distribution losses were not effectively monitored throughout the financial year. Given the lack of systems in place, it was impractical to determine the full extent of the losses.

### **Opinion**

16. In my opinion, except for the possible effects of the matters described in the Basis for qualified opinion paragraphs, the financial statements present fairly, in all material respects, the financial position of the Ndlambe Local Municipality 30 June 2012 and its financial performance and cash flows for the year then ended, in accordance with SA Standards of GRAP and the requirements of the MFMA.

### **Emphasis of matters**

17. I draw attention to the matters below. My opinion is not modified in respect of these matters

### **Restatement of corresponding figures**

18. As disclosed in note 41 to the financial statements, the comparative figures for 30 June 2011 have been restated as a result of errors discovered during the financial year ended 30 June 2012 in the financial statements of the municipality at, and for the year ended, 30 June 2011.

### **Material Impairments**

19. The municipality incurred material impairment on its receivable balances during the year. The debt impairment recognised per the statement of financial performance and disclosure note four and five was R16,2 million (2011: R17,4 million) while R27,1 million (2011: R16,2 million) of the opening provision was written off as irrecoverable.

### **Material under spending of the budget/conditional grant**

20. As disclosed in the note 39 to the financial statements the Ndlambe local municipality has materially under spent its capital budget. At the date of this report, under spending amounted to R9,4 million (2011: R20,1 million), which translates into incomplete infrastructure projects and consequently impacts on service delivery.
21. As disclosed in the note 11 to the financial statements, the municipality has materially under spent the conditional grants and receipts to the amount of R14,9 million (2011: R17,5 million). As a consequence, the local municipality has not achieved its objectives of completing the relevant capital projects.

### **Additional matter**

22. I draw attention to the matters below. My opinion is not modified in respect of this matter.

### **Unaudited supplementary schedules**

23. The supplementary information set out on page 47 does not form part of the financial statements and is presented as additional information. I have not audited this schedule and, accordingly, I do not express an opinion thereon.

## REPORT ON OTHER LEGAL AND REGULATORY REQUIREMENTS

### PAA REQUIREMENTS

24. In accordance with the PAA and the *General Notice* issued in terms thereof, I report the following findings relevant to performance against predetermined objectives, compliance with laws and regulations and internal control, but not for the purpose of expressing an opinion.

#### Predetermined objectives

I performed procedures to obtain evidence about the usefulness and reliability of the information in the annual performance report as set out on pages ... to ... of the annual report.

25. The reported performance against predetermined objectives was evaluated against the overall criteria of usefulness and reliability. The usefulness of information in the annual performance report relates to whether it is presented in accordance with the National Treasury annual reporting principles and whether the reported performance is consistent with the planned development priorities. The usefulness of information further relates to whether indicators and targets are measurable and relevant as required by the *National Treasury Framework for managing programme performance information*.

The reliability of the information in respect of the selected development priorities is assessed to determine whether it adequately reflects the facts.

The material findings are as follows:

#### **Usefulness of information**

##### **Presentation**

**Measures taken to improve performance were not explained in the annual performance report**

26. Section 46 of the Municipal Systems Act, 2000 (Act No. 32 of 2000) (MSA) requires the disclosure of measures taken to improve performance in the annual performance report where planned targets were not achieved. Adequate and reliable corroborating evidence could not be provided for 91 % measures taken to improve performance as disclosed in the annual performance report. The local municipality's records did not permit the application of alternative audit procedures. Consequently, I did not satisfy myself as to the validity, accuracy and completeness of the measures taken to improve performance.

##### **Consistency**

**Reported indicators not consistent or not complete when compared with planned indicators/measures**

27. The MSA, section 41(c) requires that the actual achievements against all planned indicators must be reported annually. The annual performance report submitted for audit purposes did not include the actual performance of 66% of all planned indicators specified in the integrated development plan for the year under review. This was due to limited review and monitoring of the completeness of reporting documents by management.

**Reported objectives not consistent or not complete when compared with planned objectives**

28. The MSA, section 41(c) requires that the actual achievements against all planned indicators and targets must be reported annually. The annual performance report submitted for audit purposes did not include the actual performance of 27% of all planned objectives specified in the integrated development plan for the year under review. This was due to limited review and monitoring of the completeness of reporting documents by management.

## **Measurability**

### **Indicators not verifiable**

29. The National Treasury *FMPPI* requires that it must be possible to validate the processes and systems that produce the indicator. A total of 56% of the indicators relevant to Basic Services, Institutional Transformation and Development, Local Economic Development, Municipal Financial Viability and Management and Good Governance were not verifiable in that valid processes and systems that produce the information on actual performance did not exist. This was due to the lack of oversight responsibility exercised by management.

### **Performance targets not specific**

30. The National Treasury *FMPPI* requires that performance targets be specific in clearly identifying the nature and required level of performance. A total of 49% of the targets relevant to Basic Services, Institutional Transformation and Development, Local Economic Development, Municipal Financial Viability and Management and Good Governance were not specific in clearly identifying the nature and the required level of performance. This was due to the lack of oversight responsibility exercised by management.

### **Performance targets not measurable**

31. The National Treasury *FMPPI* requires that performance targets be measurable. The required performance could not be measured for a total of 49% of the targets relevant to Basic Services, Institutional Transformation and Development, Local Economic Development, Municipal Financial Viability and Management and Good Governance. This was due to the lack of oversight responsibility exercised by management.

### **Performance targets not time bound**

32. The National Treasury *FMPPI* requires that the time period or deadline for delivery be specified. A total of 49% of the targets relevant to Basic Services, Institutional Transformation and Development, Local Economic Development, Municipal Financial Viability and Management and Good Governance were not time bound in specifying a time period or deadline for delivery. This was due to the lack of oversight responsibility exercised by management.

## **Reliability of information**

### **Reliability of selected programmes in the annual performance report**

33. The National Treasury *FMPPI* requires that processes and systems which produce the indicator should be verifiable; that the indicator be accurate enough for its intended use and respond to changes in the level of performance; and that documentation addressing the systems and processes for identifying, collecting, collating, verifying and storing information be properly maintained. I was unable to obtain all the information and explanations I considered necessary to satisfy myself as to the validity of the actual reported performance relevant to 67% of Basic Services and Municipal Financial Viability and Management. This was due to limitations placed on the scope of my work due to the absence of information systems and the institution's records not permitting the application of alternative audit procedures.
-

### **Compliance with laws and regulations**

34. I performed procedures to obtain evidence that the entity has complied with applicable laws and regulations regarding financial matters, financial management and other related matters. My findings on material non-compliance with specific matters in key applicable laws and regulations as set out in the *General Notice* issued in terms of the PAA are as follows:

### **Strategic and performance management**

35. The municipality did not establish mechanisms to monitor and review its performance management system, as required by section 40 of the MSA. Additionally, the audit committee did not review the performance management system.
36. The municipality did not set measurable performance targets with regard to each development priority and objective, monitor performance, with regard to each of those development priorities and objectives and against the key performance indicators and targets set, measure and review performance at least once per year, with regard to each of those development priorities and objectives and against the key performance indicators and targets set, take steps to improve performance with regard to those development priorities and objectives where performance targets are not met; as required by section 41 of the MSA.

### **Budgets**

37. Quarterly reports were not submitted to the council on the implementation of the budget and financial state of affairs of the municipality within 30 days after the end of each quarter, as required by section 52(d) of the MFMA.

### **Annual financial statements, performance and annual reports**

38. The financial statements submitted for auditing were not prepared in all material respects in accordance with the requirements of section 122 of the MFMA.
39. Material misstatements identified by the auditors in the submitted financial statements were partially corrected and supporting records were provided subsequently, where possible. In instances where supporting records could not be provided material misstatement identified were not corrected and this resulted in the financial statements receiving a qualified audit opinion.
40. The municipal council did not adopt an oversight report, containing comments on the annual report, within two months from the date on which the 2011 annual report was tabled, as required by section 129(1) of the MFMA.
41. The annual performance report for the year under review does not include a comparison of the performance with set targets nor measures taken to improve performance, as required by section 46 (1)(a) / (b) / (c) of the MSA.

### **Audit committee**

42. The audit committee did not advise the council, accounting officer and the management staff on matters relating to the adequacy, reliability and accuracy of financial reporting and information, which results in non compliance with Section 166(2)(a)(iv) of the MFMA.
43. The audit committee did not review the annual financial statements to provide the council with an authoritative and credible view of the financial position of the entity, its efficiency and effectiveness and its overall level of compliance with the MFMA and DoRA and other applicable legislation, which results in non compliance with Section 166(2)(b) of the MFMA.
44. The audit committee did not review the municipality's performance management system and/or make recommendations to the council, as required by Municipal Planning and Performance Management Regulation 14(4)(a)(ii).

45. The audit committee did not review the quarterly internal audit reports on performance measurement, as required by Municipal Planning and Performance Management Regulation 14(4)(a)(i).
46. The audit committee did not submit at least twice during the financial year, an audit report on the review of the performance management system to the council, as required by Municipal Planning and Performance Management Regulation 14(4)(a)(iii).

#### **Internal audit**

47. The internal audit unit did not report to the audit committee on matters relating to compliance with the MFMA, the DoRA and other applicable legislation, as required by section 165(2)(b) of the MFMA.
48. The internal audit did not audit the results of performance measurements, as required by section 45(1)(a) of the MSA and Municipal Planning and Performance Management Regulation 14(1)(a).
49. The internal audit unit did not assess whether the performance management system complied with the requirements of the MSA and the extent to which the performance measurements were reliable in measuring the performance of the municipality on key and general performance indicators, as required by Municipal Planning and Performance Management Regulation 14(1)(b)(ii) and (iii).
50. The internal audit unit did not audit the performance measurements on a continuous basis and/or submitted quarterly reports on their audits to the municipal manager and the performance audit committee, as required by Municipal Planning and Performance Management Regulation 14(1)(c).

#### **Expenditure management**

51. Money owing by the municipality was not always paid within 30 days of receiving an invoice or statement, as required by section 65(2)(e) of the MFMA.
52. Sufficient appropriate audit evidence could not be obtained that payments had been approved by the accounting officer or a properly authorised official as required by section 11(1) of the MFMA.
53. The accounting officer did not take effective steps to prevent unauthorised, irregular and fruitless and wasteful expenditure, as required by section 62(1)(d) of the MFMA.
54. One instance of irregular expenditure was not recovered from the liable person, as required by section 32(2) of the MFMA and was not reported to the South African Police Service as required by section 38(1)(b)(ii) of the Municipal Supply Chain Management Regulations.

#### **Asset management**

55. An adequate management, accounting and information system which accounts for assets was not in place, as required by section 63(2)(a) of the MFMA.
56. An effective system of internal control for assets, including an adequate fixed asset register, was not in place, as required by section 63(2)(c) of the MFMA.

#### **Procurement and contract management**

57. Goods and services with a transaction value of below R200 000 were procured without obtaining the required price quotations as required by SCM regulation 17(a) & (c).
58. Quotations were accepted from prospective providers who are not registered on the list of accredited prospective providers and do not meet the listing requirements prescribed by the SCM policy in contravention of SCM regulation 16(a) and 17(b).



59. Goods and services of a transaction value above R200 000 were procured without inviting competitive bids, as required by SCM regulation 19(a). Deviations were approved by the accounting officer even though it was not impractical to invite competitive bids, in contravention of SCM regulation 36(1)(a).
60. Invitations for competitive bidding were not always advertised for a required minimum period of days, as required by SCM regulation 22(1)(b) & 22(2).
61. Sufficient appropriate audit evidence could not be obtained that contracts and quotations were awarded to bidders based on points given for criteria that were stipulated in the original invitation for bidding and quotations, as required by SCM Regulations 21(b) and 28(1)(a)(i) and Preferential Procurement Regulations.
62. Sufficient appropriate audit evidence could not be obtained that bid adjudication was always done by committees which were composed in accordance with SCM regulation 29(2).
63. The preference point system was applied in the procurement of goods and services above R30 000 in terms of PPPFA sec 2(a) and SCM reg. 28(1)(a)(ii).
64. The allocation and calculation of preference points was not in all circumstances correctly done in accordance with the requirements of the PPPF Act and PPPR.
65. Awards were not in all circumstances made to the supplier scoring the highest points, in terms of PPPFA section 2(1)(f).
66. The performance of the contractor was not in all circumstances monitored on a monthly basis in terms of MFMA section 116(2)(b).
67. The contract performance measures and the methods whereby they are monitored were not sufficient to ensure effective contract management, in terms of MFMA section 116(2)(c).
68. The winning providers did not in all circumstances submit an original tax clearance certificate from SARS certifying the tax affairs of that person to be in order or that suitable arrangements had been made with SARS in terms of SCM reg. 43.
69. The winning providers did not in all circumstances submit a declaration of interest where the following was declared, in terms of SCM reg. 13(c):
  - i) Whether he/she was in the service of state or had been in the service of state for the previous twelve months;
  - ii) If the provider is not a natural person, whether any of its directors, managers, principal shareholders or stakeholders were in the service of the state, or had been in the service of the state in the previous twelve months;
  - iii) Whether the spouse, child or parent of the provider or a director, manager, shareholder or stakeholder of a provider who is a company or cc, was in the service of the state or had been in the service of the state for the previous twelve months.
70. The auditee did not compile a list of accredited prospective providers used for procurement through quotations in terms of SCM reg. 14(1)(a)(i) & (3).
71. Prospective providers were not invited to apply for evaluation and listing at least once a year, through local representative newspapers or by any other appropriate means in terms of SCM reg. 14(1)(a)(ii).
72. Sufficient appropriate audit evidence could not be obtained that all contracts and quotations were awarded in accordance with the legislative requirements and a procurement process which is fair, equitable, transparent and competitive, as relevant requested information was not provided. The local municipality's records did not permit the application of alternative audit procedures.

### **Conditional grants receipts**

73. The municipality did not submit quarterly performance reports to the transferring national officer, provincial treasury and the National Treasury, within 30 days after the end of each quarter, as required by section 12(2)(c) of the DoRA.
74. The municipality did not evaluate its performance in respect of programmes funded by the allocation and submit the evaluation to the transferring national officer within two months after the end of the financial year, as required by section 12(6) of the DoRA.
75. The municipality did not submit, within 20 days after the end of each month, its monthly expenditure reports to the national department (CoGTA), as required by the Division of Revenue Grant Framework, Gazette No.34280.

### **Internal control**

76. I considered internal control relevant to my audit of the financial statements, annual performance report and compliance with laws and regulations. The matters reported below under the fundamentals of internal control are limited to the significant deficiencies that resulted in the basis for qualified opinion, the findings on the annual performance report and the findings on compliance with laws and regulations included in this report.

### **Leadership**

77. Management have not effectively exercised its oversight responsibility over compliance with laws and regulations and financial and performance management. Irregular expenditure has been incurred by the entity due to contraventions of the supply chain management regulations which can be contributed to the lack of effective oversight over these regulations. The lack of effective oversight also resulted in material misstatements in the financial statements and the performance information not being useful and reliable.

### **Financial and performance management**

78. Management has failed to implement effective internal controls over adequate presentation and preparation of the financial statements resulting in numerous findings during the audit relating to presentation and accuracy of financial information in the financial statements. This includes failure to implement adequate controls over the identification of irregular expenditure and ensuring that all irregular expenditure is disclosed in the annual financial statements.
79. Management further did not implement adequate controls over the reporting on predetermined objectives resulting in information not being useful or reliable to users and decision makers.

### **Governance**

80. The audit committee and the internal audit did not function effectively in 2012, which has resulted in SCM contraventions, findings on performance information reported and material misstatements to the financial statements.

## OTHER REPORTS

### Investigations

81. One investigation was concluded in 2012 into the allegation of fraud surrounding a confirmed SCM contravention. Irregular expenditure of R1,1 million was included in the current year, due to spending against the related contract, and is included in the amount per note 37.

*Auditor-General.*

Auditor-General

East London

30 November 2012



AUDITOR-GENERAL  
SOUTH AFRICA

*Auditing to build public confidence*